



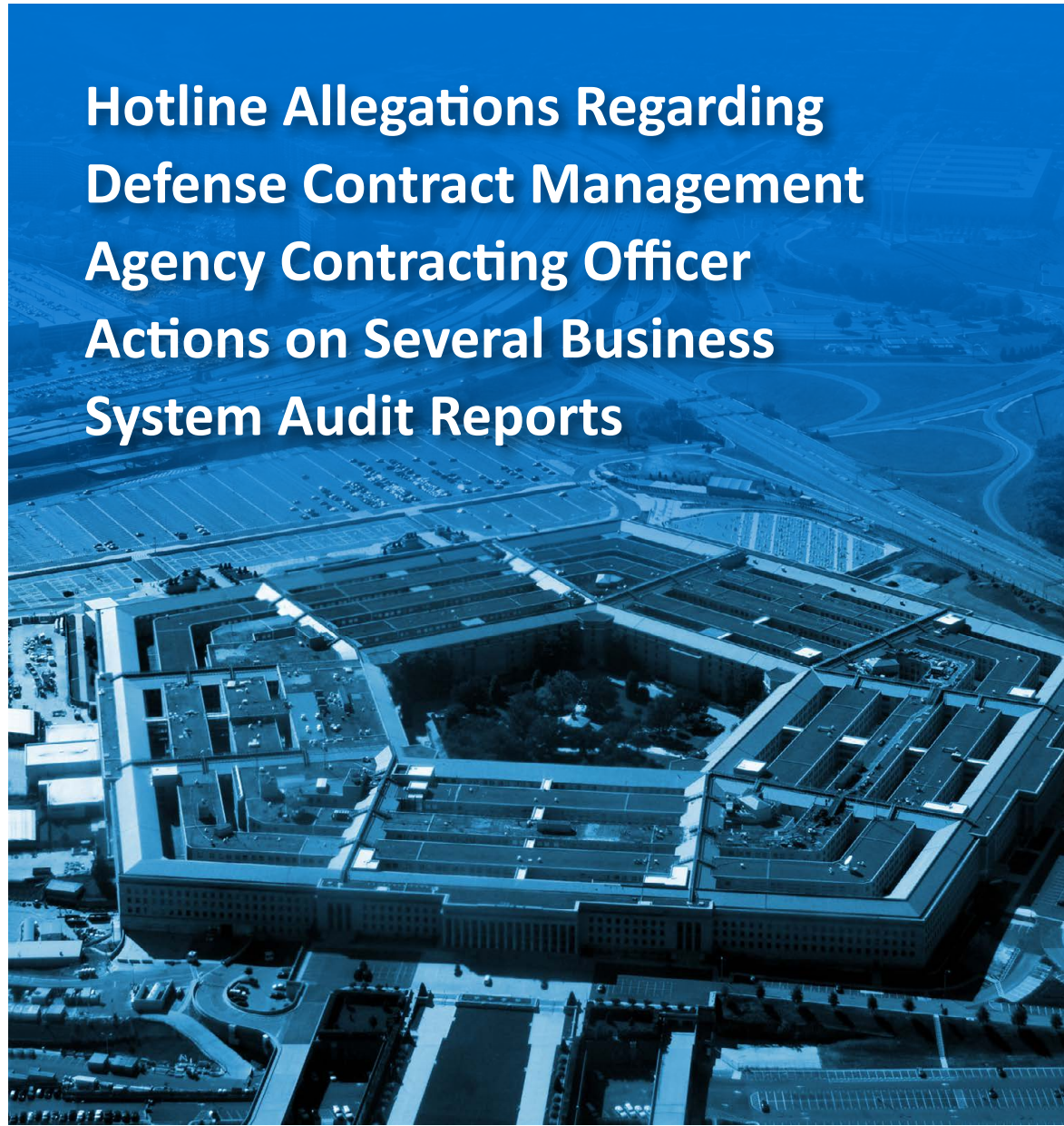
# INSPECTOR GENERAL

*U.S. Department of Defense*

JUNE 20, 2014



## Hotline Allegations Regarding Defense Contract Management Agency Contracting Officer Actions on Several Business System Audit Reports



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# Results in Brief

## *Hotline Allegations Regarding Defense Contract Management Agency Contracting Officer Actions on Several Business System Audit Reports*

June 20, 2014

### Objective

We conducted this review to determine the validity of a DoD Hotline complaint alleging that a Defense Contract Management Agency (DCMA) contracting officer did not take timely or appropriate action on several Defense Contract Audit Agency (DCAA) audit reports covering the business systems of a large DoD contractor.

### Finding

We substantiated the DoD Hotline complaint. Even though the Defense Federal Acquisition Regulation Supplement states that the contracting officer should make a final determination within 30 days, the DCMA contracting officer has taken up to 1,373 days as of March 25, 2014. In addition, the contracting officer has not implemented withholdings for significant deficiencies.

Also, the DCAA field audit office has not conducted timely follow-up audits of the reported business system deficiencies. Finally, DCAA did not obtain sufficient evidence in support of its July 29, 2013, memorandum stating that the contractor appeared to have implemented adequate controls for the remaining estimating system deficiencies.

### Recommendations

The Director, DCMA, should:

- instruct the contracting officer to make a final determination on the compensation system.
- Ensure the contracting officer implements withholdings for any disapproved business systems.
- Develop a written corrective action plan for improving DCMA quality assurance procedures to help ensure timely final determinations and implementation of monetary withholdings for significant deficiencies.

In addition, we recommend that DCAA rescind its July 29, 2013, memorandum addressing the estimating system and initiate follow-up audits of the reported business system deficiencies.

### Management Comments and Our Response

Of the five recommendations for DCMA, the Director, DCMA, agreed with two and partially agreed with three. The DCMA comments and planned corrective actions are fully responsive to all five recommendations.

Of the three recommendations for DCAA, the Director, DCAA, agreed in principle with one and did not agree with two. The Director did not agree to rescind its July 29, 2013, memorandum, which addressed the contractor's estimating system. We request that the Director, DCAA, provide additional comments on Recommendations 2.a and 2.b. See the Recommendations Table on the following page. We request the additional comments by July 21 2014.

## ***Recommendations Table***

Management	Recommendations Requiring Comment	Recommendations Not Requiring Comment
Director, Defense Contract Management Agency		1.a, 1.b, 1.c, 1.d, and 1.e
Director, Defense Contract Audit Agency	2.a and 2.b	2.c

Please provide comments by July 21, 2014.





INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500

June 20, 2014

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY  
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY


SUBJECT: Hotline Allegations Regarding Defense Contract Management Agency Contracting  
Officer Actions on Several Business System Audit Reports  
(Report No. DODIG-2014-084)

We are providing this report for your review and comment. We substantiated an allegation that a contracting officer failed to make timely final determinations on four business systems at a major DoD contractor facility. The contracting officer also did not implement monetary withholds for significant business system deficiencies, as Defense Federal Acquisition Regulation Supplement 252.242-7005 clause requires.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We considered management comments on a draft of this report when preparing the final report. The Director, Defense Contract Management Agency, provided comments that were responsive to all recommendations. We request additional comments from the Director, Defense Contract Audit Agency, for Recommendations 2.a, and 2.b. We should receive the additional comments by July 21, 2014.

Please send a PDF file containing your comments to the e-mail address cited in the last paragraph of this memorandum. Copies of your comments must have the actual signature of the authorizing official for your organization. We cannot accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to our staff. Questions should be directed to Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877), [Carolyn.davis@dodig.mil](mailto:Carolyn.davis@dodig.mil).

  
Randolph R. Stone  
Deputy Inspector General  
Policy and Oversight

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## Acronyms and Abbreviations

# Introduction

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## Objective

We conducted this review to determine the validity of a DoD Hotline complaint alleging that a Defense Contract Management Agency (DCMA) contracting officer did not take timely or appropriate action on several Defense Contract Audit Agency (DCAA) audit reports covering the business systems of a large DoD contractor.

See the appendix for details of our scope and methodology.

## Background

### ***Defense Contract Audit Agency***

DCAA performs DoD contract audits and provides accounting and financial advisory services in connection with the negotiation, administration, and settlement of DoD contracts and subcontracts. DCAA operates under the authority, direction, and control of the Under Secretary of Defense (Comptroller).

DCAA maintains a Headquarters, a Field Detachment, and five regions: Central, Eastern, Mid-Atlantic, Northeastern, and Western. Each region maintains multiple field audit offices (FAOs).

The Agency performs several types of contract audits, such as audits of contractor claimed incurred costs, forward pricing proposals, and business systems. DCAA performs periodic audits of contractor business systems (including the accounting, estimating, material management, and compensation systems) to test the existence of adequate internal controls and the reliance the Government can place on transactions processed by the business systems. DCAA advises the cognizant contracting officer as to whether the systems contain significant deficiencies that require contractor corrective action.

### ***Defense Contract Management Agency***

DCMA is a component of the DoD that works directly with DoD contractors to ensure that DoD, Federal, and allied government supplies and services are delivered on time and at projected cost, and meet all performance requirements.



DCMA contracting officers are responsible for several contract administrative functions, such as approving or disapproving contractor business systems, determining final indirect cost rates on cost-reimbursement contracts, and evaluating contractor compliance with the Cost Accounting Standards. DCMA contracting officers use the DCAA audit report and other expert advice to help them determine whether to approve or disapprove contractor business systems.

This report addresses the actions that a DCMA corporate administrative contracting officer (hereafter referred to as the contracting officer) took in response to four business system audits issued by DCAA in 2010 and 2011. This contracting officer was responsible for determining the adequacy of the business systems and taking any other related actions required by the Defense Federal Acquisition Regulation Supplement. The contracting officer retired in January 2013. DCMA assigned an acting contracting officer between January and March 2013, and selected another permanent contracting officer in April 2013.

## Finding

### Failure to Make Timely Final Determinations Regarding Contractor Business Systems

We substantiated the complainant's allegation that the contracting officer failed to make timely final determinations regarding the adequacy of four contractor business systems. The failure to make a timely final determination increases the Government's risk that significant business system deficiencies will remain uncorrected and the Government cannot rely on transactions processed by the business systems. Although the DCMA contracting officer should have made a final determination within 30 days, the contracting officer has taken up to 1,373 days as of March 25, 2014. In addition, the contracting officer has not implemented a payment withholding to protect the Government's interests for the significant deficiencies, as Defense Federal Acquisition Regulation Supplement (DFARS) clause 252.242-7005 requires. In addition, we noted that DCAA has not performed timely follow-up audits of significant reported deficiencies associated with the contractor's compensation, billing, accounting, and estimating systems.

### Allegation

The complainant alleged that the DCMA contracting officer failed to make timely final determinations on the adequacy of four contractor business systems: the accounting, billing, compensation, and estimating systems. The complainant stated that DCAA issued audit reports to the contracting officer that identified significant system deficiencies with each system. However, the contracting officer did not take appropriate action to resolve the deficiencies.

### *Revised Business System Requirements*

In recent years, reported inadequacies with contractor business systems have led to the enactment of major changes to related DoD regulations. On September 21, 2009, the Commission on Wartime Contracting reported that unreliable data produced by contractor business systems cost the Government billions of dollars. The Commission criticized DCAA and DCMA for not providing effective oversight of contractor business systems. For example, the Commission found that DCMA often approved business systems based on only a corrective action plan and rarely reduced or suspended progress payments to protect the Government's interests for system deficiencies.

Section 893 of the National Defense Authorization Act for FY 2011 required that DoD develop a program for the improvement of contractor business systems to ensure that such systems provide timely, reliable information. On May 18, 2011, DoD published an interim rule, which added DFARS clause 252.242-7005, “Contractor Business Systems” (hereafter referred to as the business systems clause), and amended other related sections of the DFARS. The business systems clause serves, in part, as an enforcement mechanism for use by contracting officers, requiring them to withhold 5 percent of contractor payments on contracts that contain the clause when they make a final determination that a significant system deficiency exists. Prior to the interim rule, contracting officers could exercise discretion on whether to withhold payments.

Under the interim rule, DoD also revised related DFARS Procedures, Guidance, and Instructions (PGIs). For example, DFARS PGI 242.7502, “Contractor Accounting Systems and Related Internal Controls,” states that the contracting officer should issue a final determination within 30 days after receiving the contractor’s response on reported deficiencies. If the final determination reflects that significant deficiencies exist, it must also include a notification of withholding payments for contracts which include the business systems clause.

With minor changes, the interim rule was adopted as a final rule on February 24, 2012.

### ***DCAA Business System Audit Reports***

As shown in Table 1, an FAO in the DCAA Western Region issued four reports in 2010 and 2011 on the business systems of the major DoD contractor.

*Table 1: DCAA Business System Reports*

Business System Report Description	Issue Date
Compensation System	May 18, 2010
Billing System	November 18, 2010
Accounting System	November 24, 2010
Estimating System	February 15, 2011

Each of the reports addressed significant system deficiencies. For example, regarding the estimating system, the FAO found that information from the contractor’s management systems was not being appropriately and accurately integrated into cost estimates used in forward pricing proposals. The FAO cited several examples when this deficiency resulted in cost estimates that were not reliable,

verifiable, supportable, or properly documented. The FAO recommended that the contracting officer implement monetary withholds to protect the Government's interests until the deficiencies were corrected.

### ***Actions Taken on DCAA Reports***

After receiving the DCAA reports, the contracting officer requested that the contractor provide a written response to the reported deficiencies. In the contractor's responses, the contractor disagreed in principle with some of the reported findings, but agreed to take several corrective actions. As DFARS clause 252.242-7005(f) requires, the contractor eventually notified the contracting officer in writing that it had completed the corrective actions for each system. Table 2 shows the dates associated with receipt of the contractor's response, contractor notification on completion of corrections, and contracting officer issuance of the final determination.

*Table 2: Dates of Actions on Business Systems*

Business System	Receipt of Contractor Response	Contractor Notification of Corrections	Issuance of Final Determination
Compensation System	June 21, 2010	November 3, 2010	Not Issued
Billing System	May 23, 2011	May 23, 2011	February 1, 2012
Accounting System	February 3, 2011	July 20, 2011	October 4, 2011
Estimating System	July 21, 2011	January 9, 2012	August 6, 2013

Within approximately 8 months after receiving the contractor notifications on the billing and accounting systems, the contracting officer issued final determinations to approve both systems.

Regarding the estimating system, the contracting officer took nearly 19 months after receiving the January 9, 2012, contractor notification to approve the system. Until July 29, 2013, DCAA had advised the contracting officer that five significant deficiencies still remained despite the contractor notification. However, on July 29, 2013, DCAA issued a memorandum informing the contracting officer that the contractor appeared to have implemented adequate controls to address the remaining deficiencies. The contracting officer approved the system within days after receiving the DCAA memorandum.

Even though the contracting officer has also proposed to approve the compensation system, the contracting officer has not yet received the necessary authorization to do so by DCMA's Board of Review Committee. DCMA procedures

require contracting officers to obtain Committee approval of a final determination on a business system when the contracting officer proposes not to adopt auditor recommendations. The Committee advised the contracting officer that additional testing of the contractor's corrective actions needs to take place before it could authorize the proposed determination.

For all four systems, the contracting officer elected not to implement withholdings at any time after receiving the DCAA audit reports. Except for the estimating system, the contracting officer documented in the file that withholdings were not implemented because the contractor had already corrected the DCAA-reported deficiencies. In support of not implementing withholdings for the estimating system, the contracting officer wrote:

...it would be difficult to support an argument that the remaining outstanding conditions constitute shortcomings in [the contractor's] estimating system that materially affect the Government's ability to rely upon information produced by the system that is needed for management purposes sufficient to support a system inadequacy finding and withholding of payments.  
(DoD contractor name omitted)

### ***Failure to Make Timely Determinations and Withhold Payments***

The contracting officer did not make timely final determinations on the contractor's business systems. Table 3 depicts the number of days the contracting officer has taken as of March 25, 2014, to make final determinations on the four systems after receiving the contractor's response to each audit report.

*Table 3. Number of Days to Make the Final Determination on Business Systems*

Business System	Receipt of Contractor Response	Issuance of Final Determination	Elapsed Days Between Receipt of Response and Final Determination (or March 25, 2014, if no determination)
Compensation System	June 21, 2010	Not Issued	1,373 (no determination yet)
Billing System	May 23, 2011	February 3, 2012	256
Accounting System	February 3, 2011	October 4, 2011	243
Estimating System	July 21, 2011	August 6, 2013	747

The elapsed days far exceed the related DFARS PGI for each system [for example, DFARS PGI 242.7502(d)] which states that the contracting officer should make a final determination within 30 days after receiving the contractor's response.

We do not question the contracting officer's ultimate final determination to approve the accounting, billing, or estimating systems. However, the contracting officer should not have waited several months while the contractor made corrective actions in order to make the final determinations. In the case of the estimating system, the contractor took 22 months after DCAA issued its report to implement adequate corrective actions (from July 2011 to May 2013). In the meantime, the Government was at risk for the significant deficiencies and it could not rely on information produced by those systems. For all four systems, particularly after the DFARS interim rule became effective on May 18, 2011, the contracting officer needed to promptly make a determination that significant deficiencies existed and implement withholdings on contracts containing the business systems clause in order to protect the Government's interests. Then, as directed in DFARS clause 252.242-7005(e)(2), the contracting officer should have reduced the withholdings to reflect the contractor's progress in correcting the deficiencies. Finally, the contracting officer should have eliminated the withholdings only after receiving sufficient evidence to conclude that the deficiencies were corrected.

Regarding the estimating system, we disagree strongly with the contracting officer's statement that "...it would be difficult to support an argument that the remaining outstanding conditions constitute shortcomings in [the contractor's] estimating system..." (contractor name omitted). The outstanding deficiencies that DCAA had communicated to DCMA beginning in July 2011 would have clearly constituted a significant deficiency as defined in DFARS 252.242-7005(b). As a result of the estimating deficiencies, DoD contracting officials who conducted substantial business with this contractor did not have the benefit of audited rates and factors for several years when they attempted to negotiate a fair and reasonable value on individual price proposals.

Because the contracting officer has yet to make a final determination on the compensation system, the contracting officer must promptly do so in accordance with the DFARS. If significant deficiencies remain, the final determination must include a notice to withhold payments. In determining whether significant deficiencies remain, the contracting officer should consult with the DCAA FAO and carefully consider recent evidence it has provided on the status of the deficiencies.



As previously stated, DCMA has been criticized in the past for not taking appropriate action on contractor business systems. In September 2009, 8 months before the contracting officer began receiving the DCAA reports, the Commission on Wartime Contracting criticized DCMA for not implementing withholdings to protect the Government's interests. Even after issuance of the DFARS interim rule, some DCMA contracting officers were not making timely final determinations or withholding payments for system deficiencies.

In a December 14, 2012, "Notice of Concern,"<sup>1</sup> we pointed out that another DCMA contracting officer had inappropriately postponed the final determination on estimating system deficiencies for 1 year and 5 months because the contracting officer wanted to wait until DCAA completed its follow-up audit. As in this case, the contracting officer did not implement withholdings to protect the Government's interests while waiting for the follow-up. In response to the Notice of Concern, the Director, Defense Contract Management Agency, stated that the Agency would continue to monitor, train, and meet with employees in order to improve timeliness and compliance with regulatory requirements. We request that DCMA provide us with specific actions taken and planned to help ensure compliance with the business systems clause.

### ***The Business Systems Clause was Required***

In accordance with the May 18, 2011, DFARS interim rule, contracting officers are required to incorporate the business systems clause into all DoD contracts subject to the Cost Accounting Standards.

The contracting officer documented in the file that the business systems clause does not apply because none of the contractor's contracts contain the clause. However, we discovered several contracts that should include the business systems clause because they were executed after May 18, 2011, and subject to the Cost Accounting Standards. On June 25, 2013, we requested that DCMA determine if these contracts actually contain the clause as required, but DCMA has not yet notified us of its determination.

Although the DCMA contracting officer did not personally execute these contracts, the DCMA contracting officer was responsible for administering them and determining the adequacy of the contractor business systems. Therefore, if the

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<sup>1</sup> We issue a Notice of Concern to alert DoD management of significant findings that require immediate attention. DoD management officials can then take proactive steps to mitigate the effects of the findings.

business systems clause was omitted in error, the DCMA contracting officer should have instructed the contracting officials who executed the contracts to add the clause. An omission of the business systems clause could compromise the DCMA contracting officer's ability to effectively oversee contractor business systems and protect the Government's interests for significant deficiencies.

In the December 14, 2012, Notice of Concern, we advised the Director, Defense Contract Management Agency, of an instance at another DoD contractor facility where several contracts did not include the business systems clause as required. If the contracting officer in this case determines that business systems clause was omitted in error, the contracting officer must immediately instruct the appropriate contracting officials to modify the contracts in order to insert the clause.

### **Untimely DCAA Follow-Up Audits**

The DCAA FAO has not completed any follow-up audits of the significant deficiencies reported in the four business system reports. The FAO only recently initiated follow-up audits of the accounting and compensation systems and does not anticipate starting audits of the billing and estimating systems until FY 2014. Although DCAA provided the DCMA contracting officer with limited advice on the contractor's corrective action plans, such advice is not a substitute for performing a comprehensive follow-up audit of previously reported deficiencies. (Also see "DCAA Advice on the Estimating System" below which addresses our concerns regarding a recent memorandum DCAA issued on estimating system corrective actions.)

DCAA Contract Audit Manual 5-104f, "Audit Objectives," states that the auditor should place a high priority on conducting follow-up audits of previously reported business system deficiencies. Yet, the FAO told us that the follow-up audits were delayed in part because of other priority work and staffing constraints. DCAA needs to timely report on the status of business system deficiencies it has previously reported so that the contracting officer can take appropriate action based on the contractor's current progress in correcting the deficiencies. Accordingly, DCAA should promptly initiate follow-up audits of the business system deficiencies.

In a June 11, 2013, draft report for Project No. D2012-DIP0AI-0030.000, we found that another DCAA FAO took an unreasonable amount of time to perform a follow-up audit of significant business system deficiencies. We recommended that DCAA assess the timeliness of business system follow-up audits on an agency-wide basis and make appropriate improvements to its related quality assurance procedures. Currently, we have no additional recommendations for this issue.

## **DCAA Advice on the Estimating System**

In a July 29, 2013, memorandum to the contracting officer, the DCAA FAO stated, "...it appears [the contractor] has implemented adequate controls to address the remaining estimating deficiencies..." (contractor name omitted) After receiving the memorandum, the contracting officer issued a final determination to approve the contractor's estimating system.

However, DCAA acknowledges that it did not perform sufficient testing of the actual implementation of the corrective actions, procedures, or internal controls to determine their operational effectiveness. Therefore, we question the appropriateness of the DCAA advice. Generally Accepted Government Auditing Standard 6.56 states, "Auditors must obtain sufficient, appropriate, evidence to provide a reasonable basis for their findings and conclusions." Because the DCAA FAO did not perform sufficient testing in support of whether the contractor had implemented adequate controls, the DCAA FAO should notify the contracting officer that it is rescinding the July 29, 2013, memorandum. As previously stated, DCAA should initiate a follow-up audit of the corrective actions and gather sufficient evidence to determine conclusively if the actions have eliminated the reported estimating system deficiencies. The contracting officer can re-assess the approval determination, if necessary, once DCAA issues a follow-up report.

## **Recommendations, Management Comments, and Our Response**

### ***Recommendation 1***

**We recommend that the Director, Defense Contract Management Agency:**

- a. Instruct the contracting officer to promptly make a final determination on the contractor's compensation system.**

*Director, Defense Contract Management Agency Comments*

The Director, DCMA partially agreed. The Director agreed that a contracting officer should take timely and appropriate action in accordance with the DFARS. However, a contractor's compensation system is not a business system subject to approval or disapproval. Nevertheless, DCMA will ensure the assigned contracting officer takes appropriate action on the reported compensation system deficiencies, and documents a determination of the effect on the estimating and accounting systems.

*Our Response*

Although the DCMA Director partially agreed, the comments are responsive and no further comments are required for this recommendation. We recognize that the compensation system is now considered a component of the contractor's accounting system. At the time DCAA issued its report of compensation system deficiencies, the DFARS had identified 10 business systems (including the compensation system). With the issuance of the DFARS clause on May 18, 2011, the 10 business systems were consolidated into 6. The compensation system is now considered a component of the accounting system. We agree the contracting officer should review the current status of the reported compensation system deficiencies as a component of the accounting system and make a final determination based on the DFARS clause.

- b. Ensure that the contracting officer implements withholdings on contracts that contain Defense Federal Acquisition Regulation Supplement Clause 252.242-7005, if any significant compensation system deficiencies remain.**

*Director, Defense Contract Management Agency Comments*

The DCMA Director partially agreed. The Director, DCMA agrees that the contracting officer should withhold payments for compensation system deficiencies that are considered significant and result in the disapproval of the accounting system. The Director clarified that the contracting officer would not withhold payments unless it resulted in the disapproval of a business system.

*Our Response*

Although the Director, DCMA, partially agreed, the management comments are responsive and no additional comments are needed for this recommendation.

**c. Develop a written corrective action plan for helping to ensure that contracting officers:**

- (1) Make timely final determinations on business systems.**
- (2) Implement withholdings on contractor business systems in accordance with applicable sections of the Defense Federal Acquisition Regulation Supplement.**

*Director, Defense Contract Management Agency Comments*

The Director, DCMA, agreed and has developed procedures to help ensure contracting officers make timely final determinations on business systems and implement withholdings for significant deficiencies. DCMA is rewriting its instructions to clearly articulate the requirements and expectations for making prompt determinations. Also, DCMA is updating the instructions to align final determinations with audit dispositions and to specify timeframes for accomplishing those actions. For systems that are disapproved, the DCMA Contractor Business System Review Panel will oversee contracting officer actions to help ensure they adhere to the expected timelines. The panel will also ensure contracting officers implement monetary withholds in accordance with the DFARS clause 252.242-7005 and agency policy.

*Our Response*

The management comments are responsive and no additional comments are required.

**d. Provide a copy of the written corrective action plan requested in Recommendation 1.c to the Assistant Inspector General for Audit Policy and Oversight.**

*Director, Defense Contract Management Agency Comments*

The Director, DCMA, agreed. The Director stated that DCMA's proactive steps discussed in the comments on Recommendation 1.c will demonstrate progress toward contracting officers making timely final determinations on business systems and implementing withholds in accordance with DFARS clause 252.242-7005. Also, DCMA will provide copies of its relevant instructions and memoranda that will address and reinforce its procedures for ensuring timely determinations.

### *Our Response*

The DCMA management comments are responsive and no additional comments are required.

**e. Review all contracts issued on or after May 18, 2011, subject to the Cost Accounting Standards and:**

- (1) Ensure that contracting officials included Defense Federal Acquisition Regulation Supplement Clause 252.242-7005(e.**
- (2) Instruct contracting officials to insert the business systems clause if it was omitted in error.**

### *Director, Defense Contract Management Agency Comments*

The Director, DCMA, partially agreed. The Director recognizes the agency's responsibility to review contracts delegated to it for administration and to highlight instances when contracts do not contain appropriate clauses. DCMA updated its instructions to require that contracting officers review all contracts for the existence of the business system requirements. The updated instructions also require DCMA contracting officers to issue a written request that procurement contracting officers modify contracts for the business system clause.

### *Our Response*

The DCMA management comments are responsive and no additional comments are required.

## **Recommendation 2**

**We recommend that the Director, Defense Contract Audit Agency, instruct the Regional Director, Western Region, to:**

- a. Rescind the July 29, 2013, memorandum to the contracting officer stating that the contractor appeared to have corrected the remaining estimating deficiencies.**
- b. Advise the contracting officer that the memorandum has been rescinded.**



*Director, Defense Contract Audit Agency Comments*

The Director, DCAA, disagreed. According to the Director, the FAO does not need to rescind the memorandum because the memorandum:

1. did not offer an audit opinion or state that DCAA performed an audit in accordance with generally accepted government auditing standards (GAGAS);
2. clearly stated that DCAA performed “limited follow-up procedures;”
3. conveyed that the auditor “did not perform sufficient testing of the actual implementation of the corrective actions, procedures, or internal controls to determine their operational effectiveness;” and
4. was requested by the contracting officer to help fulfill the duties outlined in DFARS 252.242-7005(e)(2), which requires the contracting officer to determine if “the contractor is effectively implementing” a corrective action plan “in consultation with the auditor;”

The Director also commented that performing a follow-up audit would not have been a prudent use of scarce DCAA resources because the contractor had just fully implemented the corrective actions in May 2013 (when the contractor submitted its forward pricing rate proposal).

*Our Response*

The Director, DCAA, comments are not responsive and we request additional comments. We maintain that the FAO should rescind the July 29, 2013, memorandum. As explained below, we disagree with the rationale DCAA provided in support of not rescinding the memorandum.

1. The July 29, 2013, memorandum contained the following DCAA opinion (or “opinion-like” statement):

*...it appears [the contractor] has implemented adequate controls* to address the remaining estimating deficiencies...”  
(contractor name omitted and emphasis added)

Throughout the memorandum the FAO also conveyed the opinion that the various corrective actions were “adequate.” The opinions are inconsistent and incompatible with the preceding sentence in the memorandum which states:

*We did not perform sufficient testing of the actual implementation* of the corrective actions, procedures, or internal controls to determine their operational effectiveness.  
(emphasis added)

Regardless of whether or not this was a GAGAS-covered engagement, the DCAA FAO should have refrained from opining that the contractor had implemented adequate controls if it had not performed sufficient testing of the actual implementation. The memorandum also did not comply with DCAA procedures in DCAA Memorandum No. 12-PAS-012(R), April 24, 2012, which states in part:

A deficiency would be considered outstanding unless the contractor has corrected the deficiency and DCAA has performed a follow-up audit and found the corrective action effective.

The Director commented that the FAO was providing only an advisory service (also referred to as a “nonaudit” service) using limited procedures, not an audit in accordance with GAGAS. GASAS 2.12 states:

When performing nonaudit services for an entity for which the audit organization performs a GAGAS audit, audit organizations should communicate with requestors and those charged with governance to clarify that the work performed does not constitute an audit conducted in accordance with GAGAS.

We found no evidence suggesting the FAO had clarified to the contracting officer that the work performed did not constitute an audit. Neither the July 29, 2013, memorandum nor the July 9, 2013, memorandum acknowledging the contracting officer’s request contained such a clarification.

The July 29, 2013, memorandum indicates that the DCAA FAO performed “limited procedures” which FAO and the contracting officer agreed on. Such an arrangement is consistent with an agreed-upon procedure engagement described in GAGAS and the DCAA Contract Audit Manual. For this type of engagement, the auditor should not express an opinion or conclusion. The DCAA FAO did not comply with DCAA Contract Audit Manual 2-101.2, because the memorandum provided an opinion and positive assurance that the contractor had implemented adequate controls. Instead, the memorandum should have disclaimed an opinion on the adequacy of the controls in accordance with the DCAA procedure.

2. While the memorandum clearly stated the auditor had performed limited procedures (which did not include sufficient testing of the actual implementation), the FAO did not limit its conclusions or opinions to the stated procedures. Instead, the FAO provided a level of assurance regarding the adequacy of the implemented controls that was inconsistent with the level of testing described in the memorandum.
3. Although the July 29, 2013, memorandum conveyed that the auditor did not “perform sufficient testing of the actual implementation...,” the memorandum inappropriately reflected that the contractor had implemented adequate controls.
4. We do not object to the DCAA FAO providing appropriate advice through a memorandum to help the contracting officer determine the status of the contractor’s corrective actions in accordance with DFARS 252.242-7005(e)(2). Nonetheless, DCAA inappropriately advised DCMA that the contractor had implemented adequate controls despite not testing the actual implementation of those controls. The inappropriate advice could have led the contracting officer to prematurely approve the estimating system before confirming that the corrective actions were implemented and operating effectively.

Therefore, the FAO should rescind the memorandum and advise the contracting officer not to rely on it for taking any future contracting actions. The FAO should initiate a follow-up audit because the contractor has asserted that the corrective actions were fully implemented and the FAO can gather sufficient data to test the effectiveness of the actions.

- c. promptly initiate follow-up audits of the reported business system deficiencies to determine if the contractor has eliminated them.**

### *Director, Defense Contract Audit Agency Comments*

The Director, DCAA, agreed in principle that follow-up audits should be promptly initiated after the contractor implements the corrective actions and sufficient information exists to confirm that corrective actions are sufficient. DCAA plans to schedule an audit in FY 2014. However, the Director disagreed that it is unreasonable for the FAO to take 3 years to perform a follow-up audit of significant business system deficiencies. The Director further states “the contractor did not fully implement its corrective actions until May 2013.” Therefore, the Director does not believe it would have been prudent to perform a follow-up audit until the contractor completed the corrective actions.

### *Our Response*

The management comments are responsive and no additional comments are required. On March 20, 2014, the DCAA FAO advised that it plans to begin work on three follow-up audits in April and one follow-up audit in June 2014.

However, the contractor had notified the Government that the corrective actions for all systems were completed as of January 2012, yet the DCAA FAO does not plan to complete the follow-up audits until 2015. The following table shows the actual dates of the contractor’s notification and the estimated dates for completing each follow-up audit.

*Table 4. Time Elapsed Between Notification of Contractors’ Corrective Actions and DCAA’s Follow-Up Audit*

Business System	Contractor Notification of Corrections	Estimated Completion of Follow-up Audit	Time Between Notification and Estimated Completion
Compensation System	November 3, 2010	June 30, 2015	4 years, 8 months
Billing System	May 23, 2011	No Estimate (June 2014 start)	At least 3 years, 1 month
Accounting System	July 20, 2011	April 15, 2015	3 years, 9 months
Estimating System	January 9, 2012	April 15, 2015	3 years, 3 months

The FAO currently has no estimate for completing the billing system follow-up audit, but it plans to start the audit in June 2014.

We reiterate that the FAO's follow-up audits are untimely. The FAO should have initiated follow-up audits shortly after the contractor notified the Government it had completed the corrective actions and sufficient data existed to test their effectiveness. If a follow-up audit discloses that the corrective actions are either not fully implemented or ineffective, the follow-up audit report should reflect the deficiencies as still outstanding. Conducting an untimely follow-up audit has limited usefulness for a contracting officer, especially when the contracting officer has already made a final determination on the reported deficiencies.

The FAO supervisor explained that, although three of the four follow-up audits were started, he had to postpone them for "other priority work." The postponements are not consistent with Agency policy which indicates that follow-up audits of significant business system deficiencies should be given high priority. Nevertheless, we are encouraged by the FAO's recent decision to restart the audits in April and June 2014. We are also encouraged by DCAA's recent effort to begin assessing the timeliness of follow-up audits and identifying opportunities for improving timeliness agency-wide. We will monitor the FAO's progress in completing the follow-up audits, and DCAA's effort to identify improvement opportunities.

## Appendix

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### Scope and Methodology

We conducted this review in accordance with the Council of the Inspectors General on Integrity and Efficiency “Quality Standards for Inspection and Evaluation.” To determine the validity of the Hotline complaint addressed in this report, we:

- interviewed appropriate personnel at DCMA and DCAA;
- obtained and reviewed files and correspondence relating to the complaint; and
- reviewed DCMA contracting official actions to determine if they complied with applicable procurement regulations, DoD Instructions, and agency procedures.

We placed the interviewees under oath and recorded the interviews. In addition, we reviewed applicable regulations and agency procedures. We also reviewed written communications and other agency documents.

We performed this review from October 11, 2011, through July 29, 2013.

### ***Use of Computer-Processed Data***

We did not rely on any computer-processed data as part of our review.

### ***Prior Coverage***

During the last 5 years, the DoD Inspector General has issued four reports on Defense Hotline complaints concerning actions that DCMA took on DCAA audit reports. Unrestricted DoD Inspector General reports can be accessed at <http://www.dodig.mil/pubs/index.cfm?office=Audit>.

Report No. D-2011-6-006, “Hotline Allegation Regarding the Failure of Defense Contract Management Agency Philadelphia to Settle an Audit of a Significant Cost Accounting Change,” March 22, 2011

Report No. D-2010-6-002, “Report on Allegation of Unsatisfactory Conditions Regarding Actions by the Defense Contract Management Agency Earned Value Management Center,” July 28, 2010



Report No. D-2009-6-008, "Report on Hotline Complaint Regarding the Actions by a Contracting Officer at the Defense Contract Management Agency East Hartford Office," August 31, 2009

Report No. D-2009-6-004, "Defense Contract Management Agency Actions on Audits of Cost Accounting Standards Internal Control Systems at DOD Contractors Involved in Iraq Reconstruction Activities," April 8, 2009

# Management Comments

## Director of Defense Contract Management Agency



**DEFENSE CONTRACT MANAGEMENT AGENCY**  
3901 A AVENUE, BUILDING 10500  
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FEB 28 2014

MEMORANDUM FOR DEPARTMENT OF DEFENSE, DEPUTY INSPECTOR GENERAL,  
POLICY AND OVERSIGHT

SUBJECT: Hotline Allegations Regarding DCMA Contracting Officer Actions on Several  
Business System Audit Reports (Project D2011-DIP0AI-0285.000) – Updated  
Response

DCMA provided an initial response to your August 26, 2013 draft audit report, subject as  
above on September 20, 2013. Following clarification received from your office, we have  
updated our responses to the OIG recommendations below.

OIG Recommendation:

1. We recommend that the Director, Defense Contract Management Agency:
  - a. Instruct the CO to promptly make a final determination on the contractor's compensation system;
  - b. Ensure that the CO implements withholdings on contracts that contain Defense Federal Acquisition Regulation Supplement (DFARS) 252.242-7005, if any significant compensation system deficiencies remain;
  - c. Develop a written corrective action plan for improving DCMA quality assurance procedures to help ensure timely final determinations and implementation of monetary withholdings for significant deficiencies;
  - d. Provide a copy of the written corrective action plan requested in Recommendation 1.c to the Assistant Inspector General for Audit Policy and Oversight; and
  - e. Review all contracts issued on or after May 18, 2011, and subject to the Cost Accounting Standards to: (1) ensure that contracting officials included DFARS 252.242-7005; and (2) instruct that contracting officials insert the business systems clause if it was omitted in error.

**DCMA Response: 1.a. Partially Concur.** I agree that timely business system determinations must be made in accordance with applicable Defense Federal Acquisition Regulation Supplement (DFARS) criteria. DCMA policy clearly articulates required timelines for COs to make a final determination within 30 days of receiving a contractor's response to the initial determination (paragraph 1.4 of DCMA Instruction 131, Contractor Business Systems).

However, I do not concur with issuing final determinations for the approval or disapproval of a contractor's compensation system. As background, DFARS 252.242-7005,

## Director of Defense Contract Management Agency (cont'd)

Contractor Business Systems, defines six contractor business systems: accounting; earned value management; estimating; material management and accounting; property management; and purchasing. A contractor's compensation system is not a business system subject to approval or disapproval. As described in DCAA's Contract Audit Manual (CAM), compensation is one of several components of a contractor's system of internal controls. The effectiveness of the controls is documented using Internal Control Audit Planning Summaries (ICAPS), which summarize the auditor's assessment of control risk and the impact on related contract audit effort. The ICAPS is intended to support the audit planning process and is the primary means of communicating the results of the internal control audits to the auditors. For further information, please refer to the DCAA CAM Chapter 3, Section 3-400 and Chapter 5, Section 5-102 located at <http://www.dcaa.mil/cam.html>.

DCMA contracting officers must consider all available information when making business system determinations. While our contracting officers should not formally approve or disapprove an internal control component of a business system, they certainly should take timely and appropriate action on all information made available to them indicating the health of the system. If a contractor's compensation internal controls are found to have deficiencies that are of such magnitude to constitute a "significant deficiency", then the contracting officer must coordinate with the DCAA auditor to align those significant deficiencies to business system criteria in the regulations. To that end, we will ensure the assigned contracting officer appropriately dispositions the report of findings on the compensation internal controls, and documents a determination of effect on the Estimating and Accounting business systems.

**DCMA Response: 1.b. Partially Concur.** For those contractors whose business systems have significant deficiencies resulting in system disapproval, DCMA COs implement withholds in accordance with the DFARS clause 252.242-7005, Contractor Business Systems. DFARS 242.7000(b) (1) provides the identification of covered contracts for withholding purposes according to agency procedures. DCMA Instruction 131, Contractor Business Systems, paragraph 3.6.3.1 implements agency procedures for identifying candidates for payment withholding. While a payment withholding under 252.242-7005 would not be an appropriate action for the existence of compensation internal control deficiencies per se, payment withholds under 252.242-7005 must be considered if: the contracting officer determined the deficiencies as significant, this determination drives the disapproval of a business system, and the contractor has contracts that contain the clause 252.242-7005.

**DCMA Response: 1.c. Concur with comments.** DCMA has developed procedures to help ensure timely final determinations and implementation of monetary withholds for significant deficiencies. Furthermore, we continually monitor the timeliness of contractor business system determinations to ensure progress is made and that actions are compliant with regulatory guidance and agency policy. For example, the Cost & Pricing Center's Director of the CACO/DACO Group monitors business systems with a "not evaluated" status and reports milestones accomplished. I am also periodically briefed on contractor business system reports and audits that have not had a final determination issued.

DCMA Instruction 131, Contractor Business Systems, includes DFARS established timelines that COs must follow to make timely final determinations on business systems. The

## Director of Defense Contract Management Agency (cont'd)

DCMA Executive Director of Contracts issued an information memorandum dated May 14, 2013 to remind all COs of these timelines. Furthermore, DCMA Instruction 131 is being re-written to more clearly articulate the procedural requirements and agency expectations for making prompt determinations on contractor business systems. Likewise, DCMA Instruction 126, Contract Audit Follow Up, has been updated to specifically align business system final determinations with audit disposition and address expected timeframes for accomplishing actions.

All business system disapprovals require review by the DCMA Headquarters (HQ) Contractor Business Systems Review Panel prior to issuance of the final determination. The panel requires COs to provide a chronology of events leading to disapproval to determine if the proper timelines were followed, which provides an opportunity for feedback and accountability. The panel also ensures the CO implements withholds in accordance with DFARS 252.242-7005, Contractor Business Systems, if applicable, and agency policy.

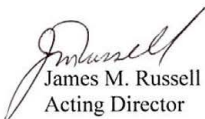
The Director, Contracts Policy, will continue to meet with the Operations Contracts Director and the Director of the CACO/DACO Group to identify possible training gaps regarding business system oversight and provide feedback from the HQ review panel on timeliness of actions. Training gaps will be addressed in follow-on online training sessions.

**DCMA Response: 1.d. Concur with comments.** DCMA's proactive steps, as described in DCMA Response 1.c, ensure progress is being made in regard to COs making timely final determinations on business systems and implementing financial withholds in accordance with DFARS 252.242-7005, Contractor Business Systems. DCMA will provide under separate cover copies of our relevant instructions and memos that address and reinforce our procedures to ensure timely determinations.

**DCMA Response: 1.e. Partially Concur.** The interim Contractor Business System Rule was published on May 18, 2011. Solicitations issued on or after May 18, 2011 and contracts issued on or after August 16, 2011 were subject to inclusion of the business systems clause, as noted in the Federal Register Notice (FRN). Responsibility for inserting DFARS 252-242-7005, Contractor Business Systems, and all other required contract clauses ultimately rests with the procuring contracting officer (PCO) who awards the contract. However, we recognize that DCMA has a responsibility to review contracts delegated to the agency for contract administration and highlighting instances where the appropriate clauses are not contained in contracts. DCMA Instruction 118, Contract Receipt and Review, was updated to include language instructing COs to review all contracts for the existence of contractor business system requirements. The policy instructs COs to issue a Contract Deficiency Report (CDR) requesting the PCO modify the contract to include DFARS 252.242-7005, Contractor Business Systems, when applicable. The DCMA Executive Director of Contracts has since reminded all COs of the importance of issuing CDRs to PCOs in an information memorandum dated January 15, 2013.

## Director of Defense Contract Management Agency (cont'd)

For further information regarding DCMA policy on Contractor Business Systems, refer to the DCMA policy publication website at <http://www.dema.mil/policy/>. Please direct any comments or questions to Stacy Strickland, Director, Contracts Policy, at (804) 734-0488 or [Stacy.Strickland@dema.mil](mailto:Stacy.Strickland@dema.mil).



James M. Russell  
Acting Director



## Director of Defense Contract Audit Agency



### DEFENSE CONTRACT AUDIT AGENCY

#### Office of the Director

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OFFICE OF THE DIRECTOR

September 26, 2013

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR POLICY AND  
OVERSIGHT, OFFICE OF THE INSPECTOR GENERAL,  
DEPARTMENT OF DEFENSE

SUBJECT: Response to Department of Defense Inspector General (DoDIG) Draft Report on  
Hotline Allegations Regarding DCMA Contracting Officer Actions on Several  
Business System Audit Reports (Project No. D2011-DIPOAI-0285.000)

Thank you for this opportunity to respond to the subject draft report issued on August 26, 2013.

#### DoDIG Recommendations

**Finding A:** *DCAA issued a memorandum to the contracting officer that stated "...it appears [the contractor] has implemented adequate controls to address the remaining estimating deficiencies...." However, DCAA did not perform sufficient testing of the actual implementation of the corrective actions, procedures, or internal controls to determine their operational effectiveness. We question the appropriateness of the DCAA advice based on GAGAS 6.56, which states: "Auditors must obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions."*

**DoDIG Recommendation 2:** We recommend that the Director, Defense Contract Audit Agency, instruct the Regional Director, Western Region, to:

- a. Rescind the July 29, 2013 memorandum to the contracting officer stating that the contractor appeared to have corrected the remaining estimating deficiencies,
- b. Advise the contracting officer that the memorandum has been rescinded.

#### DCAA Response:

**Recommendation 2.a and b:** We do not concur with the DoDIG's recommendation to rescind our July 29, 2013 memorandum to the contracting officer which states that the contractor appears to have corrected the remaining estimating deficiencies.



## Director of Defense Contract Audit Agency (cont'd)

SUBJECT: Response to Department of Defense Inspector General (DoDIG) Draft Report on Hotline Allegations Regarding DCMA Contracting Officer Actions on Several Business System Audit Reports (Project No. D2011-DIPOAI-0285.000)

As background, in June 2012, almost 14 months earlier the former contracting officer informed us that he felt the contractor had corrected the deficiencies noted in our estimating system report dated February 15, 2011, reference DCAA Audit Report No. 4911-2009B24010001. We strongly disagreed with the contracting officer given our view that several of our findings had not been adequately addressed, much less corrected. We communicated our concerns to the contracting officer in a July 20, 2012 memorandum, which likely prevented the contracting officer's disposition of estimating deficiencies we reported.

When the new permanent contracting officer was appointed in April 2013, she set out to address the outstanding estimating system deficiencies. In a letter dated June 24, 2013, she requested a follow-up audit. However, through discussion and coordination with our office it was determined that a follow-up audit would not meet her needs given the time it would take to complete the audit. Therefore, we discussed the types of services that we could provide in lieu of an audit and came to the following agreement as outlined in our July 9, 2013 acknowledgment letter:

“...our work will consist of performing limited follow-up procedures such as (i) reviewing the FPRP for general adequacy and adherence to FAR 15.408 Table 15-2, (ii) reviewing applicable policies and procedures, (iii) reviewing applicable training materials, (iv) interviewing applicable contractor personnel, and (v) and other limited procedures related to the five cited conditions. We will not be performing testing of the actual implementation of the corrective actions, procedures, or internal controls to determine their operational effectiveness.”

It is clear from the language in our acknowledgment letter that we did not offer to perform an audit or offer an audit opinion based on generally accepted government auditing standards (GAGAS). Instead, we made clear that we were only providing advisory services consisting of the limited follow-up procedures noted above. We stressed that we “will **not** be performing testing of the actual implementation of the corrective actions, procedures, or internal controls to determine their operational effectiveness.” When we communicated the results of our limited procedures in our July 29, 2013 memorandum to the contracting officer, we again clearly stated that we “performed limited follow-up procedures to determine if the contractor implemented its stated corrective actions. We did not perform sufficient testing of the actual implementation of the corrective actions, procedures, or internal controls to determine their operational effectiveness.”

The DoDIG correctly points out that GAGAS 6.56 requires that auditors “must obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions.” However, when you look at the context of this clause, it is clear that GAGAS 6.56 is referring to “findings and conclusions related to the audit objectives.” GAGAS 6.56 through 6.58 is referring to audits. We did not perform a GAGAS audit engagement. This being the case, our limited procedures and our qualified results were both appropriate and sufficient. Indeed, on page 7 of the draft report the DoDIG refers to DFARS 252.242-7005(e)(2) and says that “in

## Director of Defense Contract Audit Agency (cont'd)

**SUBJECT:** Response to Department of Defense Inspector General (DoDIG) Draft Report on Hotline Allegations Regarding DCMA Contracting Officer Actions on Several Business System Audit Reports (Project No. D2011-DIPOAI-0285.000)

determining whether significant deficiencies remain, the contracting officer should consult [emphasis ours] with the DCAA FAO and carefully consider recent evidence it has provided on the status of the deficiencies." Our July 29, 2013 memorandum was a direct result of the contracting officer consulting with us, asking for assistance and considering any recent information that we had relative to the concerns addressed in our July 20, 2012 memorandum. We believe that assisting the contracting officer is a major aspect of our DCAA mission and that our assistance was appropriate under these circumstances.

In summary, we believe our July 29, 2013 memorandum was appropriate under the circumstances and should not be rescinded for the following reasons:

- ◆ Our memo did not offer an audit opinion or state that we had performed an audit,
- ◆ We clearly stated we did "limited follow-up procedures," and we collected adequate evidence for the limited procedures,
- ◆ We clearly stated that we "did not perform sufficient testing of the actual implementation of the corrective actions, procedures, or internal controls to determine their operational effectiveness,"
- ◆ Our memorandum was requested by the contracting officer to help her fulfill her duties under DFARS 252.242-7005(e)(2) under which he/she determines if "the contractor is effectively implementing" a corrective action plan "in consultation with the auditor,"
- ◆ Because the contractor had not completely implemented its corrective actions on the estimating system deficiencies until they submitted their May 2013 forward pricing rate proposal, it would not have been a prudent use of our limited audit resources to initiate a follow-up audit of the estimating system's 12 major deficiencies.

**Finding B:** *It is unreasonable for DCAA's field audit office (FAO) to take three years to perform a follow-up audit of significant business system deficiencies.*

**DoDIG Recommendation 2.c:** We recommend that the Director, Defense Contract Audit Agency, instruct the Regional Director, Western Region, to promptly initiate follow-up audits of the reported business system deficiencies to determine if the contractor has eliminated them.

### DCAA Response:

**Recommendation 2.c: Concur in principle.** We concur that follow-up audits should be promptly initiated after the contractor has implemented sufficient corrective actions and sufficient data and information exists to confirm that the corrective actions are sufficient. We will initiate a follow-up audit of the estimating system in early FY 2014. However, we do not concur with the DoDIG's notion this it is "unreasonable for DCAA's field audit office (FAO) to take three years to perform a follow-up audit of significant business system deficiencies." As noted above, the contractor did not fully implement its corrective actions until May 2013, therefore; we do not believe it would have been prudent to perform a follow-up audit until such corrections have been completed.

## Director of Defense Contract Audit Agency (cont'd)

SUBJECT: Response to Department of Defense Inspector General (DoDIG) Draft Report on Hotline Allegations Regarding DCMA Contracting Officer Actions on Several Business System Audit Reports (Project No. D2011-DIPOAI-0285.000)

Please direct any questions regarding this memorandum to the undersigned at (703) 767-3200 or to Mr. Donald J. McKenzie, Assistant Director, Policy and Plans, at (703) 767-3280.

  
for Patrick J. Fitzgerald  
Director

## Acronyms and Abbreviations

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<b>CAM</b>	Contract Audit Manual
<b>DCAA</b>	Defense Contract Audit Agency
<b>DCMA</b>	Defense Contract Management Agency
<b>DFARS</b>	Defense Federal Acquisition Regulation Supplement
<b>FAO</b>	Field Audit Office
<b>GAGAS</b>	Generally Accepted Auditing Standards
<b>PGI</b>	Procedures, Guidance, and Instructions



# **Whistleblower Protection**

## **U.S. DEPARTMENT OF DEFENSE**

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